



A REPORT
TO THE
MONTANA
LEGISLATURE

LEGISLATIVE AUDIT
DIVISION

08-29

FINANCIAL AUDIT

Montana Water Pollution Control and Drinking Water State Revolving Fund Programs

*Department of
Environmental Quality
Department of Natural Resources
and Conservation
For the fiscal year ended
June 30, 2007*

MARCH 2008

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FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports in addition to those required by Government Auditing Standards. This individual agency audit report is not intended to comply with these requirements. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2007, was issued on January 23, 2008. The Single Audit Report for the two fiscal years ended June 30, 2009, will be issued by March 31, 2010. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
Room 277, State Capitol
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LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
Tori Hunthausen,
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:
James Gillett
Angie Grove

March 2008

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the fiscal year 2006-07 financial audit of the Montana Water Pollution Control State Revolving Fund (WPCSRF) and Drinking Water State Revolving Fund (DWSRF) Programs. The Department of Natural Resources and Conservation requested the audit of these programs because annual audits are required by the federal Environmental Protection Agency. These programs are administered jointly by the Department of Natural Resources and Conservation and the Department of Environmental Quality.

The objectives of a financial audit include determining if the programs' financial statements present fairly their financial position at June 30, 2007, and the results of the programs' operations for the fiscal year then ended. We tested compliance with state and federal laws that have a direct and material impact on the financial statements.

The WPCSRF program provides loans at a reduced interest rate to finance construction of publicly owned water pollution control facilities, nonpoint source pollution control projects, and estuary management plans. Water pollution control loans are comprised of federal grants and state match funds and may be financed up to 30 years. As of June 30, 2007, the WPCSRF had \$137,695,445 of outstanding loans, including advances to other funds.

The DWSRF program provides low interest loans to communities for the construction of drinking water treatment facilities. Drinking water loans are comprised of federal grants and state match funds and may be financed up to 30 years. At June 30, 2007, the DWSRF had \$79,251,391 of outstanding loans.

On page A-1, you will find the Independent Auditor's Report followed by the financial statements and accompanying notes. We issued an unqualified opinion which means the reader can rely on the presented information. The programs' financial statements begin on page A-3. Our opinion on the programs' supplementary financial information is on page B-1. The supplementary information begins on page B-3.

Our report on consideration of the Water Pollution Control and Drinking Water State Revolving Fund Programs' internal control over financial reporting and on our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, which is required by Government Auditing Standards, is on page C-1. Auditing standards require us to communicate, in writing, control deficiencies over financial reporting we identified based on an audit of financial statements performed

in accordance with Government Auditing Standards and considered to be significant or material. A significant deficiency affects management's ability to accurately process transactions. A material weakness is one or more significant deficiencies that adversely affect management's ability to fairly present its financial statements.

Table 1 below outlines the significant deficiencies and material weaknesses we identified during this audit.

Table 1 <u>Summary of Control Deficiencies</u>			
Subject	Significant Deficiency	Material Weakness	Page
Ineffective Controls to Ensure Proper Recording of Fund Balance Related to Loans Receivable	Yes	Yes	C-1
Ineffective Controls to Ensure Accurate Presentation of Financial Position and Results of Operations	Yes	Yes	C-1

Officials from both departments have reviewed this report and agree with its contents. The response from the departments is at page D-1. We thank the directors of the Department of Environmental Quality and the Department of Natural Resources and Conservation and their staff for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Scott A. Seacat

Scott A. Seacat
Legislative Auditor

APPOINTED AND ADMINISTRATIVE OFFICIALS

**Department of Environmental
Quality**

Richard Opper, Director

Tom Livers, Deputy Director

Dean Rude, Chief Financial Officer, Financial Services

**Department of Natural Resources
and Conservation**

Mary Sexton, Director

Anna Miller, Financial Advisor

Ann Bauchman, Administrator, Centralized Services Division

For additional information concerning the Montana Water
Pollution Control and Drinking Water State Revolving Fund
Programs, contact:

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LEGISLATIVE AUDIT DIVISION

A-1

Scott A. Seacat, Legislative Auditor
Tori Hunthausen,
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:
James Gillett
Angie Grove

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Combined Balance Sheet, Special Revenue and Debt Service Funds, of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs as of June 30, 2007, and the related Combined Statement of Revenues, Expenditures, and Changes in Fund Balances, Special Revenue and Debt Service Funds, for the fiscal year then ended. The information contained in these financial statements is the responsibility of the management of the Department of Environmental Quality and the Department of Natural Resources and Conservation. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in the notes to the financial statements, the financial statements of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs are intended to present the financial position and results of operations of only that portion of the financial reporting entity of the state of Montana that is attributable to the transactions of the programs. They do not purport to, and do not, present fairly the financial position of the state of Montana as of June 30, 2007, or the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs as of June 30, 2007, and results of operations for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 21, 2008, on our consideration of the programs' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Respectfully submitted,

/s/ *James Gillett*

James Gillett, CPA
Deputy Legislative Auditor

February 21, 2008

**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
STATE REVOLVING FUND PROGRAMS
COMBINED BALANCE SHEET
SPECIAL REVENUE AND DEBT SERVICE FUNDS
JUNE 30, 2007**

	WATER POLLUTION CONTROL			DRINKING WATER			(MEMORANDUM ONLY)
	STATE SPECIAL REVENUE	FEDERAL SPECIAL REVENUE	DEBT SERVICE	STATE SPECIAL REVENUE	FEDERAL SPECIAL REVENUE	DEBT SERVICE	TOTAL
ASSETS							
Cash and Cash Equivalents	\$17,738,335	\$53,861	\$3,549,989	\$4,857,374	\$1,960	\$2,374,537	\$28,576,056
Interest Receivable	302,221		1,260,262	171,967		616,383	2,350,833
Due from Federal Government		99,848			130,564		230,412
Prepaid Expense					30		30
Investments	1,683,342			1,345,274		124,756	3,153,372
Loans Receivable	123,424,800			79,251,391			202,676,191
Advances to Other Funds	14,270,645						14,270,645
Total Assets	\$157,419,343	\$153,709	\$4,810,251	\$85,626,006	\$132,554	\$3,115,676	\$251,257,539
LIABILITIES AND FUND BALANCES							
Liabilities:							
Accounts Payable	\$92			\$22,695	\$10,649		\$33,436
Payroll Payable	24,729	\$349		15,183	26,385		66,646
Interest Payable	77,941			6,668		\$19,598	104,207
Deferred Revenue		153,360			95,520		248,880
Total Liabilities	\$102,762	\$153,709	\$0	\$44,546	\$132,554	\$19,598	\$453,169
Fund Balances							
Reserved for Loans Receivable	\$137,695,445		\$4,810,251	\$79,251,391		\$3,096,078	\$216,946,836
Reserved for Debt Service							7,906,329
Unreserved, Undesignated	19,621,136			6,330,069			25,951,205
Total Fund Balance	\$157,316,581	\$0	\$4,810,251	\$85,581,460	\$0	\$3,096,078	\$250,804,370
Total Liabilities and Fund Balances	\$157,419,343	\$153,709	\$4,810,251	\$85,626,006	\$132,554	\$3,115,676	\$251,257,539

The accompanying notes to the financial statements are an integral part of this statement.

**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
STATE REVOLVING FUND PROGRAMS
COMBINED STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
SPECIAL REVENUE AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

	WATER POLLUTION CONTROL			DRINKING WATER			(MEMORANDUM ONLY)
	STATE SPECIAL REVENUE	FEDERAL SPECIAL REVENUE	DEBT SERVICE	STATE SPECIAL REVENUE	FEDERAL SPECIAL REVENUE	DEBT SERVICE	TOTAL
REVENUES:							
Federal Capitalization Grant Revenue		\$3,865,414			\$9,625,203		\$13,490,617
Interest Income on Investments	\$777,085		\$49,503	\$167,357		\$226,342	1,220,287
Investment Appreciation/Gains (Depreciation/Losses)	57,193		(5,012)	45,333		(17,150)	80,364
Interest Income from Loans	942,263		4,115,266	553,059		2,231,811	7,842,399
Other Income	3	43	2,586	33	236		2,901
TOTAL REVENUES	\$1,776,544	\$3,865,457	\$4,162,343	\$765,782	\$9,625,439	\$2,441,003	\$22,636,568
EXPENDITURES:							
Program Administration / Set-Asides	\$402,037	\$134,911		\$140,107	\$1,275,960		\$1,953,015
TOTAL EXPENDITURES	\$402,037	\$134,911	\$0	\$140,107	\$1,275,960	\$0	\$1,953,015
Excess Revenues Over (Under) Expenditures	\$1,374,507	\$3,730,546	\$4,162,343	\$625,675	\$8,349,479	\$2,441,003	\$20,683,553
OTHER FINANCING SOURCES:							
<i>Operating Transfers In:</i>							
Debt Service Sweep	2,127			\$298,482			300,609
Loan Loss Reserve Sweep	1,530,814			564,762			2,095,576
Federal Capitalization Grants	3,813,933			8,277,946			12,091,879
Investment Earnings from State Special Revenue			\$643,153			36,215	679,368
Total Other Financing Sources	\$5,346,874	\$0	\$643,153	\$9,141,190	\$0	\$36,215	\$15,167,432
OTHER FINANCING USES:							
Bond Principal			\$2,545,000			\$630,000	\$3,175,000
Bond Interest			631,496			539,215	1,170,711
<i>Operating Transfers Out:</i>							
Debt Service Sweep			2,127			298,482	300,609
Loan Loss Reserve Sweep			1,530,814			564,762	2,095,576
Federal Capitalization Grants		\$3,813,933			\$8,277,946		12,091,879
Investment Earnings to Debt Service	\$643,153			36,215			679,368
Total Other Financing Uses	\$643,153	\$3,813,933	\$4,709,437	\$36,215	\$8,277,946	\$2,032,459	\$19,513,143
Excess (deficiency) of Revenues and Other Financing Sources over (under) Expenditures and Other Financing Uses	\$6,078,228	(\$83,387)	\$96,059	\$9,730,650	\$71,533	\$444,759	\$16,337,842
Fund Balances July 1, 2006	\$151,266,729		\$4,714,192	75,856,027		2,651,319	\$234,488,267
Prior Year Adjustments	(28,376)	83,387		(5,217)	(71,533)		(21,739)
Fund Balances June 30, 2007	\$157,316,581	\$0	\$4,810,251	\$85,581,460	\$0	\$3,096,078	\$250,804,370

The accompanying notes to the financial statements are an integral part of this statement.

**MONTANA STATE WATER POLLUTION CONTROL AND
DRINKING WATER STATE REVOLVING FUND PROGRAMS
SPECIAL REVENUE AND DEBT SERVICE FUND
NOTES TO FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

1. Organization of the Programs

The State of Montana Water Pollution Control State Revolving Fund (WPCSRF) Program was established pursuant to Title VI of the Federal Water Quality Act of 1987. This federal act established the WPCSRF program to replace the construction grants program. It provides a flexible financing source to loan money at reduced interest rates to finance the construction of publicly owned water pollution control facilities, non-point source pollution control projects, and estuary management plans. Instead of making grants to communities that pay for a portion of building wastewater treatment facilities, the WPCSRF provides for low interest rate loans to finance the entire cost of qualified projects.

The State of Montana Drinking Water State Revolving Fund (DWSRF) Program was established pursuant to Title XIV of the Safe Drinking Water Act. This federal act established the DWSRF program for states to make loans to community water systems and non-profit non-community water systems. Instead of making grants to communities that pay for a portion of building drinking water treatment facilities, the DWSRF provides for low interest rate loans to finance the entire cost of qualified projects or to refinance debt obligations on projects that began after July 1, 1993. The State of Montana first incurred expenditures in the DWSRF Program in state fiscal year (SFY) 1997.

WPCSRF and DWSRF loan agreements allow up to 30 years for repayment. All repayments of interest and principal must remain in the revolving funds. Both programs are capitalized through U.S. Environmental Protection Agency (EPA) grants. States are required to provide 20 percent of the federal capitalization grant as matching funds for DWSRF, and 16.67 percent for WPCSRF, in order to receive a grant. The State of Montana issues General Obligation Bonds to provide the required state matching funds.

The programs are jointly administered by the Technical and Financial Assistance Bureau of the Department of Environmental Quality (DEQ) and the Conservation and Resource Development Division of the Department of Natural Resources and Conservation (DNRC). The revolving fund programs do not have any full time employees. Both funds are charged for time spent on SRF activities by department employees. The charges include salaries and benefits of the employees and operating expenses as well as indirect costs.

2. Summary of Significant Accounting Policies

A. State Revolving Fund (SRF) Program Fund Structure

Both programs use Special Revenue and Debt Service funds, as appropriate, to report the financial position and the results of operations. A Special Revenue Fund accounts for the

proceeds of specific revenue sources that are restricted to expenditures for specified purposes. A Debt Service Fund accounts for resources accumulated for payment of principal and interest on general long-term obligation debt. Montana maintains a State Special Revenue and a Federal Special Revenue Fund. The SRF program revenue and expenses include transactions from each Special Revenue Fund. Special Revenue and Debt Service Funds are considered governmental funds.

A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions and activities.

B. Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for using a current financial resources measurement focus. Current financial resources means that, generally, only assets and current liabilities are included on the balance sheet. Operating statements of governmental funds present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets.

Governmental funds use the modified accrual basis of accounting. The modified accrual basis is the accrual basis adapted to the governmental fund-type measurement focus. Under the modified accrual basis of accounting, revenues are recorded when received in cash unless susceptible to accrual. Revenues are susceptible to accrual if they are measurable and available within sixty days after the end of the fiscal year to finance expenditures of the fiscal year. Revenues are deferred if material and received before the normal time of receipt or if received for a particular activity and the expense for that activity has not been incurred prior to fiscal year-end. Expenditures are recognized when the related fund liability is incurred, with the following exceptions:

- 1) principal and interest on long-term debt are recognized when due;
- 2) prepayments are accounted for as expenditures in the period of acquisition;
- 3) inventory items are considered expenditures when purchased.

The Loans Receivable account resides in the State Special Revenue fund for each program. This account represents the total principal due on the loans outstanding for each program.

C. Prior Period Adjustments

Prior period adjustments reported in the accompanying financial statements relate to corrections of errors or other correcting adjustments from prior periods not otherwise reported as sources or uses of funds.

3. Cash/Cash Equivalents

Cash and cash equivalents consist of funds deposited with the US Bank, N.A. as trustee, and include investments categorized as cash equivalents. Cash equivalents are defined as short-term, highly liquid investments with original maturities of three months or less.

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. In accordance with the investment policy defined in the bonds trust indenture, the cash equivalent funds invested by US Bank, N.A., as trustee, are held in a Treasury Obligations Money Market Fund that invests exclusively in short-term U.S. Treasury obligations and repurchase agreements secured by U.S. Treasury obligations. The U.S. Treasury obligations in which the fund invests include U.S. Treasury bonds, notes, and bills, and are backed by the full faith and credit of the United States government.

Disclosures Relating to Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party.

The investment policy as defined in the Indenture of Trust, and contract with the trustee, does not require collateralization for cash and securities held by the trustee. Securities are registered with the Federal Reserve Bank under "U.S. Bank as trustee for the State of Montana Department of Natural Resources and Conservation." However, U.S. Bank policy is to collateralize money market funds at 101% of cost.

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The investment policy for the programs, as specified in the Indenture of Trust, does not explicitly address interest rate risk. However, the investment policy implicitly limits interest rate risk for cash equivalents by emphasizing liquidity, holding investments to maturity, and narrowly defining the eligible investments. In general, a shorter average maturity for fixed-income securities held in the money market fund means less sensitivity to interest rate changes. The average maturity in the fund as of June 30, 2007, is one day. The effective duration method result of NA is because we do not have any debt investments at this time.

<u>Investment Type</u>	<u>Book Value</u>	<u>Moody's Rating</u>	<u>Effective Duration</u>
Held by trustee:			
Money market funds	\$28,529,209	Aaa	NA

4. Investments

Power to Invest and Investment Policy

The Board of Examiners of the State of Montana authorizes the sale of general obligation bonds to provide the state match for the SRF programs through the issuance of an Indenture of Trust. The Board of Examiners is comprised of the Governor, Attorney General and the Secretary of State for the State of Montana. The Indenture of Trust specifies the eligible investments meeting defined rating and risk criteria in which the state may invest. The state invests funds through its trustee bank, US Bank, N.A.

Eligible investments are limited, generally, to obligations of, or guaranteed as to principal and interest by the United States of America, or by any agency or instrumentality thereof. A primary investment objective is to make investments that mature, or are subject to redemption, on or prior to the date or dates that the department anticipates that money will be required to make payments.

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The short- and long-term investments made by US Bank, N.A., as trustee, are held in U.S. Treasury bills and notes. U.S. Treasury bills have maturities of one year or less and U.S. Treasury notes have maturities greater than one year from the date of issuance.

Disclosures Relating to Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The investment policy as defined in the Indenture of Trust, and contract with the trustee, does not require collateralization for cash and securities held by the trustee. Securities are registered with the Federal Reserve Bank under "U.S. Bank as trustee for the State of Montana Department of Natural Resources and Conservation."

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The investment policy, as specified in the Indenture of Trust, does not explicitly address interest rate risk. However, the investment policy implicitly limits interest rate risk by emphasizing liquidity, holding investments to maturity, and narrowly defining the eligible investments. The following table includes the Effective Duration calculation for appropriate investment types, or NA to indicate that interest rate risk is not applicable. All funds of the State of Montana are required to use the effective duration method to calculate and report interest rate risk. A lower effective duration number means that there is a lower interest rate risk.

<u>Investment Type</u>	<u>Book Value</u>	<u>Effective Duration</u>
Held by trustee:		
U.S. Treasury notes	\$ 3,261,746	3.29

5. Loans Receivable

Montana operates both SRF programs as direct loan programs. Loans made to communities through the Water Pollution Control Program are funded 83.33 percent by the federal EPA capitalization grant, and 16.67 percent by the state match amount. Some Water Pollution Control Program loans are made as recycled, or "second round", loans and are disbursed from loan repayment funds. Loans made by the Drinking Water Program are funded approximately 80 percent by the federal EPA capitalization grant, and 20 percent by the state match amount. The Drinking Water Program makes recycled loans that are disbursed from loan repayment funds. Loan funds are disbursed to the local borrower agencies by the trustee bank as the local borrower agencies expend funds for the purposes of the loan and request reimbursement from the program. Interest is calculated from the date that funds are disbursed. Typically after the final disbursement has been made, the payment schedule is certified in the loan agreement and adjusted for the actual amounts disbursed. No provision for uncollectible accounts has been made as all loans are current in terms of compliance with the repayment schedules, and management believes that all loans will be repaid according to the terms of the loan agreements.

The drawn and outstanding principal balance of all loans guaranteed by the WPCSRF Program as of June 30, 2007, is \$137,695,445. The total loans receivable in the WPCSRF program includes \$123,424,800 presented as loans receivable and \$14,270,645 presented as advances to other funds. The advances are inter-fund loans within the Department of Natural Resources and Conservation used for the non-point source private loans program. The drawn and outstanding principal balance of all loans guaranteed by the DWSRF Program as of June 30, 2007, is \$79,251,391.

Loans mature at various intervals through July 1, 2036. The scheduled principal payments on loans and advances to other funds maturing in the years following state fiscal year (SFY) 2007 are as follows:

<u>SFY ending June 30:</u>	<u>WPCSRF Amount</u>	<u>DWSRF Amount</u>
2008	\$ 5,663,106	\$ 3,451,242
2009	8,357,800	4,495,504
2010	8,918,400	4,675,000
2011	9,495,400	4,904,000
2012 and thereafter	<u>105,260,739</u>	<u>61,725,645</u>
Total	\$ 137,695,445	\$ 79,251,391

As of June 30, 2007, the WPCSRF and DWSRF had authorized loans to public entities of the State of Montana that in the aggregate exceeded \$212 and \$105 million, respectively. The outstanding balances of the largest loans in each portfolio are as follows:

Water Pollution Control State Revolving Fund:

<u>Local Agency</u>	<u>Authorized Loan Amount</u>	<u>Outstanding Balance</u>
City of Great Falls	\$ 11,295,267	\$ 9,166,000
City of Helena	9,320,000	8,492,000
Big Sky/County Water & Sewer	7,000,000	6,138,000
Big Sky/County Water & Sewer	6,500,000	4,905,154
Big Sky/County Water & Sewer	5,513,000	2,450,000
City of Lewistown	5,400,000	4,923,000
Missoula WWTP	5,000,000	4,094,000
City of Missoula SID 524	4,577,000	3,597,000
Billings	4,515,000	4,280,000
Missoula County Mullan Rd RSID 8474	4,498,121	2,780,000
Total	\$ 63,618,388	\$ 50,825,154

Drinking Water State Revolving Fund:

<u>Local Agency</u>	<u>Authorized Loan Amount</u>	<u>Outstanding Balance</u>
City of Billings*	\$ 17,300,000	\$ 13,355,000
City of Havre II	8,401,000	7,368,000
City of Whitefish II	5,839,000	4,034,000
City of Laurel	5,250,000	3,389,000
City of Lewistown	3,549,000	3,405,000
City of East Helena	3,234,000	2,659,000
Helena	2,850,000	2,688,000
City of Great Falls	3,000,000	2,332,000
Laurel II	2,541,000	2,130,000
City of Helena II*	2,750,000	230,547
Total	\$ 54,714,000	\$ 41,590,547

* They are still drawing funds.

6. Interest Receivable

The interest receivable represents interest owed by borrowers as of June 30, 2007, for the July 1, 2007 payment. It represents the six months of interest accrued from the previous loan payment date of January 1, 2007. Interest receivable balances include \$282,418 in the WPCSRF Special Administration fund and \$1,174,553 in the WPCSRF Debt Service and Loan Loss Reserve funds; and \$146,663 in the DWSRF Special Administration fund and \$585,852 in the DWSRF Debt Service and Loan Loss Reserve funds. Interest receivable does not include interest payments received in June, 2007 that were due July 1, 2007. Interest payments received during June 2007 amounted to \$1,0751,184 for the WPCSRF and \$660,141 for the DWSRF.

7. Bonds Payable

Water Pollution Control SRF general obligation bonds payable at June 30, 2007, were as follows:

Series 1998A

<u>Payable during the year ending June 30,</u>	<u>Interest Range (%)</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	3.75 – 5.15	\$ 155,000	\$ 116,469	\$ 271,469
2009		165,000	109,308	274,308
2010		170,000	101,685	271,685
2011		180,000	93,545	273,545
2012		190,000	84,755	274,755
2013-2017		1,080,000	272,423	1,352,423
2018-2019		510,000	26,460	536,460
Total Cash Requirements		\$ 2,450,000	\$ 804,645	\$ 3,254,645

Series 2000B

<u>Payable during the year ending June 30,</u>	<u>Interest Range (%)</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	4.25 – 5.60	\$ 130,000	\$ 137,459	\$ 267,459
2009		135,000	130,983	265,983
2010		145,000	124,086	269,086
2011		155,000	116,623	271,623
2012		160,000	108,668	268,668
2013-2017		950,000	376,894	1,326,894
2018-2021		985,000	140,768	1,125,768
Total Cash Requirements		\$ 2,660,000	\$ 1,135,481	\$ 3,795,481

Series 2001H

<u>Payable during the year ending June 30,</u>	<u>Interest Range (%)</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	4.00 – 5.00	\$ 110,000	\$ 98,795	\$ 208,795
2009		115,000	94,295	209,295
2010		115,000	89,695	204,695
2011		120,000	84,920	204,920
2012		125,000	79,820	204,820
2013-2017		720,000	308,378	1,028,378
2018-2022		905,000	116,515	1,021,515
Total Cash Requirements		\$ 2,210,000	\$ 872,418	\$ 3,082,418

Series 2003D

<u>Payable during the year ending June 30,</u>	<u>Interest Range (%)</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	2.00 – 3.75	\$ 160,000	\$ 30,612	\$ 190,612
2009		165,000	27,239	192,239
2010		170,000	23,426	193,426
2011		175,000	19,023	194,023
2012		180,000	14,050	194,050
2013-2014		<u>375,000</u>	<u>11,610</u>	<u>386,610</u>
Total Cash Requirements		\$ 1,225,000	\$ 125,960	\$ 1,350,960

Series 2004A

<u>Payable during the year ending June 30,</u>	<u>Interest Range (%)</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	2.00 – 4.50	\$ 1,205,000	\$ 63,468	\$ 1,268,468
2009		155,000	36,285	191,285
2010		160,000	32,148	192,148
2011		165,000	27,473	192,473
2012		165,000	22,316	187,316
2013-2015		<u>540,000</u>	<u>30,358</u>	<u>570,358</u>
Total Cash Requirements		\$ 2,390,000	\$ 212,048	\$ 2,602,048

Series 2005G

<u>Payable during the year ending June 30,</u>	<u>Interest Range (%)</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	4.00 – 4.75	\$ 110,000	\$ 84,490	\$ 194,490
2009		115,000	79,990	194,990
2010		120,000	75,290	195,290
2011		120,000	70,490	190,490
2012		125,000	65,590	190,590
2013-2017		<u>725,000</u>	<u>241,431</u>	<u>966,431</u>
2018-2021		<u>705,000</u>	<u>62,861</u>	<u>767,861</u>
Total Cash Requirements		\$ 2,020,000	\$ 680,142	\$ 2,700,142

TOTAL GENERAL OBLIGATION DEBT - WPCSRF

Payable during the year

<u>ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 1,870,000	\$ 531,293	\$ 2,401,293
2009	850,000	478,100	1,328,100
2010	880,000	446,330	1,326,330
2011	915,000	412,074	1,327,074
2012	945,000	375,199	1,320,199
2013-2017	4,390,000	1,241,094	5,631,094
2018-2022	<u>3,105,000</u>	<u>346,604</u>	<u>3,451,604</u>
Total Cash Requirements	\$ 12,955,000	\$ 3,830,694	\$ 16,785,694

Drinking Water SRF general obligation bonds payable at June 30, 2007, were as follows:

Series 1998F

<u>Payable during the year</u>	<u>Interest</u>			
<u>ending June 30,</u>	<u>Range (%)</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	3.60 – 4.85	\$ 145,000	\$ 96,940	\$ 241,940
2009		150,000	90,855	240,855
2010		155,000	84,449	239,449
2011		160,000	77,675	237,675
2012		170,000	70,413	240,413
2013-2017		965,000	225,778	1,190,778
2018-2019		<u>450,000</u>	<u>22,013</u>	<u>472,013</u>
Total Cash Requirements		\$ 2,195,000	\$ 668,123	\$ 2,863,123

Series 2000A

<u>Payable during the year</u>	<u>Interest</u>			
<u>ending June 30,</u>	<u>Range (%)</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	4.25 – 5.60	\$ 120,000	\$ 123,400	\$ 243,400
2009		125,000	117,413	242,413
2010		130,000	111,132	241,132
2011		135,000	104,540	239,540
2012		145,000	97,467	242,467
2013-2017		855,000	361,921	1,216,921
2018-2021		<u>880,000</u>	<u>101,446</u>	<u>981,446</u>
Total Cash Requirements		\$ 2,390,000	\$ 1,017,319	\$ 3,407,319

Series 2001G

<u>Payable during the year ending June 30,</u>	<u>Interest Range (%)</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	4.00 – 5.00	\$ 125,000	\$ 117,465	\$ 242,465
2009		135,000	112,265	247,265
2010		140,000	106,765	246,765
2011		145,000	100,974	245,974
2012		150,000	94,834	244,834
2013-2017		855,000	366,441	1,221,441
2018-2022		<u>1,075,000</u>	<u>138,047</u>	<u>1,213,047</u>
Total Cash Requirements		\$ 2,625,000	\$ 1,036,791	\$ 3,661,791

Series 2003E

<u>Payable during the year ending June 30,</u>	<u>Interest Range (%)</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	2.00 – 3.75	\$ 100,000	\$ 18,560	\$ 118,560
2009		100,000	16,485	116,485
2010		105,000	14,150	119,150
2011		105,000	11,472	116,472
2012		110,000	8,460	118,460
2013-2014		<u>225,000</u>	<u>6,998</u>	<u>231,998</u>
Total Cash Requirements		\$ 745,000	\$ 76,125	\$ 821,125

Series 2005F

<u>Payable during the year ending June 30,</u>	<u>Interest Range (%)</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	4.00 – 4.75	\$ 200,000	\$ 157,300	\$ 357,300
2009		210,000	149,100	359,100
2010		215,000	140,600	355,600
2011		225,000	131,800	356,800
2012		235,000	122,600	357,600
2013-2017		1,330,000	454,438	1,784,438
2018-2022		<u>1,300,000</u>	<u>120,325</u>	<u>1,420,325</u>
Total Cash Requirements		\$ 3,715,000	\$ 1,276,163	\$ 4,991,163

TOTAL GENERAL OBLIGATION DEBT - DWSRFPayable during the year
ending June 30,

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 690,000	\$ 513,665	\$ 1,203,665
2009	720,000	486,118	1,206,118
2010	745,000	457,096	1,202,096
2011	770,000	426,461	1,196,461
2012	810,000	393,774	1,203,774
2013-2017	4,230,000	1,415,576	5,645,576
2018-2022	<u>3,705,000</u>	<u>381,831</u>	<u>4,086,831</u>
Total Cash Requirements	\$ 11,670,000	\$ 4,074,521	\$ 15,744,521

8. Fund Balance

A portion, or all, of the fund balances in the WPCSRF and DWSRF have been reserved for Loans Receivable and Debt Service, indicating that a portion, or all, of the fund balances are not available for current expenditures.

9. Program Capitalization

The WPCSRF and DWSRF programs are capitalized by grants from the Environmental Protection Agency (EPA) and matching funds from the State of Montana. All grant funds drawn are recorded as revenue. As of June 30, 2007, the EPA has awarded capitalization grants of \$118,360,565 to the State of Montana for the WPCSRF program; \$210,382,301 has been drawn from federal and state funds for loans and administrative expenses. As of June 30, 2007, the EPA has awarded capitalization grants of \$94,060,788 to the State of Montana for the DWSRF program; \$102,559,403 has been drawn from federal and state funds for loans and administrative expenses. Montana has issued general obligation bonds totaling \$24,590,000 for use as state matching funds for the WPCSRF program and \$14,795,000 for use as state matching funds in the DWSRF program.

10. Federal Capitalization Grant Revenues

Actual draws of federal funds differ from the amount of Federal Capitalization Grant Revenue reported on the Statement of Revenues, Expenditures and Changes in Fund Balance. This occurs because state accounting policy requires federal special revenue funds reflect a zero fund balance at fiscal year-end (with the exception of "A" accruals). Consequently, if a positive fund balance exists, deferred revenue is recorded. If a negative fund balance is reflected at fiscal year-end, a revenue accrual to record revenue is recorded to zero the fund balance.

The following is a reconciliation of federal revenues reported on the financial statements to federal cash actually drawn during the state fiscal year:

WPCSRF

Federal Revenue - Combined Statement	\$3,865,414
Adjustment Due From Federal Govt FY06	8,717
Adjustment Deferred Revenue FY06	(13,479)
Adjustment Due From Federal Govt FY07	(99,806)
Adjustment Deferred Revenue FY07	153,360
Other Adjustments	35,120
Total Federal Draws	\$3,949,326

DWSRF

Federal Revenue - Combined Statement	\$9,625,203
Adjustment Due From Federal Govt FY06	65,337
Adjustment Deferred Revenue FY06	(47,418)
Adjustment Due From Federal Govt FY07	(130,564)
Adjustment Deferred Revenue FY07	95,331
Total Federal Draws	\$9,607,889

11. Interest Income on Investments

This revenue represents interest earnings on investments within the funds. All assets of the funds are fully invested by the trustee, to the degree possible, in investment vehicles. The investments range from U.S. Treasury obligation money market funds to long-term government securities. Interest income earned in one fund but transferred to another fund in accordance with terms of the bond indenture is reported in the receiving fund in which it becomes available for expenditure.

12. Other Investment Income

This revenue represents unamortized (premium) and discount recognized upon maturity or disposal of government securities, as well as the change in unrealized appreciation and (depreciation) in the market value of investments as of June 30, 2007.

13. Interest Income from Loans

This revenue represents interest earnings from loan repayments made by borrowers. A typical loan carries an interest rate of 4%; however, during fiscal year 2004 the rate was decreased to 3.75% for new loans and the lower rate was continued through fiscal year 2007. The 3.75% is comprised of a loan interest rate of 2.00%, as well as a 1.00% Loan Loss Reserve fee and a 0.75% Special Administration fee. The interest income for each of these components totaled \$3,064,345, \$1,041,198, and \$978,471, respectively, for the WPCSRF program; and \$1,581,706, \$630,102, and \$552,977, respectively, for the DWSRF program. Disadvantaged communities can receive loans with an interest rate of 2.75% because no Loan Loss Reserve fee is levied.

14. Program Administration and Set-Aside Funds

This expenditure represents costs incurred by DEQ and DNRC to administer the SRF programs. This amount is limited to 4% of each grant award from the EPA. Program Administration appears under the Resource Development/Recreation function in the State of Montana Comprehensive Annual Financial Report (CAFR).

The DWSRF program includes several “sub-programs”, called set-asides, which states can elect. A State may use a certain portion of its capitalization grants for the following activities:

- up to 4 percent of its capitalization grants to administer the DWSRF and provide technical assistance to public water systems;
- up to 2 percent of its grants to provide assistance to small public water systems;
- up to 10 percent of its grants for state program management activities, including administration of the State Public Water System Supervision Program, administration of the source water protection program, development and implementation of the capacity development and operator certification programs;
- up to 15 percent of its grants to assist in the development and implementation of local drinking water protection initiatives and other State programs.

In the DWSRF, the 4 percent administrative set-aside must be deposited to a separate fund, and must have separate accounting and disclosure.

DWSRF Program Administration/Set-Asides Detail:

Administration - EPA Grants	\$327,740
Administration - State Funds	140,107
Technical Assistance	191,519
State Program Management	754,886
Local Assistance	1,815
Total Administration and Set-Asides	\$1,416,067

In the WPCSRF program, there are no set-aside funds available.

WPCSRF Program Administration Detail:

Administration - EPA Grants	\$134,911
Administration - State Funds	402,037
Total Administration	\$536,948

15. Other Financing Sources and Uses

Loan interest amounts received that exceed the debt service requirements are shown as a Financing Source and Use on the financial statements. The balance remaining in the Debt Service fund is transferred to the Investment account in the State Special Revenue fund. Both funds are required by the State Revolving Fund Program. This occurs after payments are made to the bondholders on July 15 of each year. In the Arbitrage Certificate, this activity is termed a Debt Service Sweep.

The Loan Loss Reserve Sweep represents cash in excess of the reserve requirement that is transferred from the Loan Loss Reserve fund to the Principal fund per the bond indenture. The Loan Loss Reserve fund is not required by the State Revolving Fund Program, but the state elected to have this fund to account for these funds separately.

When DEQ receives money from EPA, it is deposited into an account at US Bank, who then makes distributions to the borrowers when they become approved for the loans. These distributions are recorded in SABHRS monthly. The loan payments, made by the cities and counties, are recorded at DNRC in a State Special Revenue fund.

16. Subsequent Events

In August 2007, two Bond Anticipation Notes (BAN) were issued for \$500,000 each. These BANs were to match EPA Capitalization Grant funds. They were paid off on January 10, 2008. There may be additional BANs or bonds issued in FY 2008 to match EPA funds.

LEGISLATIVE AUDIT DIVISION

B-1

Scott A. Seacat, Legislative Auditor
Tori Hunthausen,
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:
James Gillett
Angie Grove

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs' financial statements. The Montana Water Pollution Control and Drinking Water Schedule of Revolving and Non-Revolving SRF Programs Balance Sheet, Special Revenue and Debt Service Funds, Regulatory Basis, as of June 30, 2007, and the related Schedule of Revolving and Non-Revolving SRF Program Revenues, Expenditures, and Changes in Fund Balances, Special Revenue and Debt Service Funds, Regulatory Basis for the year then ended are presented for the purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the programs' financial statements and, in our opinion, is fairly stated in all material respects in relation to the programs' financial statements taken as a whole.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

February 21, 2008

**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
SCHEDULE OF REVOLVING AND NON-REVOLVING SRF PROGRAMS
BALANCE SHEET
SPECIAL REVENUE AND DEBT SERVICE FUNDS
REGULATORY BASIS
JUNE 30, 2007**

	WATER POLLUTION CONTROL SPECIAL REVENUE		WATER POLLUTION CONTROL DEBT SERVICE FUND		DRINKING WATER SPECIAL REVENUE		DRINKING WATER DEBT SERVICE FUND		(MEMORANDUM ONLY) TOTAL
	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	
ASSETS									
Cash and Cash Equivalents	\$15,336,570	\$2,455,626	\$1,898,324	\$1,651,665	\$3,314,928	\$1,544,406	\$1,112,913	\$1,261,624	\$28,576,056
Interest Receivable		302,221	872,392	387,870	11,469	160,498	425,212	191,171	2,350,833
Due from Federal Government	99,848				130,564				230,412
Prepaid Expense					30				30
Investments	698,089	985,253			1,147,758	197,516		124,756	3,153,372
Loans Receivable	123,424,800				79,251,391				202,676,191
Advances from Other Funds	14,270,645								14,270,645
Total Assets	\$153,829,952	\$3,743,100	\$2,770,716	\$2,039,535	\$83,856,140	\$1,902,420	\$1,538,125	\$1,577,551	\$251,257,539
LIABILITIES AND FUND BALANCES									
Liabilities:									
Accounts Payable		\$92			\$10,651	\$22,693			\$33,436
Payroll Payable	\$418	\$24,660			26,385	\$15,183			66,646
Interest Payable	45,441	32,500			6,668			\$19,598	104,207
Deferred Revenue	153,360				95,520				248,880
Total Liabilities	\$199,219	\$57,252	\$0	\$0	\$139,224	\$37,876	\$0	\$19,598	\$453,169
Fund Balances									
Reserved for Loans Receivable	137,695,445				79,251,391				\$216,946,836
Reserved for Debt Service			2,770,716	2,039,535			1,538,125	1,557,953	\$7,906,329
Unreserved, Undesignated	15,935,288	3,685,848			4,465,525	1,864,544			25,951,205
Total Fund Balances	\$153,630,733	\$3,685,848	\$2,770,716	\$2,039,535	\$83,716,916	\$1,864,544	\$1,538,125	\$1,557,953	\$250,804,370
Total Liabilities and Fund Balances	\$153,829,952	\$3,743,100	\$2,770,716	\$2,039,535	\$83,856,140	\$1,902,420	\$1,538,125	\$1,577,551	\$251,257,539

This schedule is prepared on a regulatory basis of presentation, rather than a GAAP (1) basis, as requested by the Environmental Protection Agency (EPA) for the Water Pollution Control and Drinking Water State Revolving Fund (SRF) Programs. This presentation separates certain regulated Revolving Fund (within the Fund) and Non-Revolving Fund (outside the Fund) activity by fund type. All proceeds from the EPA Capitalization Grant, corresponding state matching funds, and loan principal and interest repayments must be deposited into the Revolving Fund under Title VI of the Clean Water Act and Title XIV of the Safe Drinking Water Act. Other proceeds, including Administration and Origination Fees and Loan Loss Reserves are deposited into the Non-Revolving Fund and may be used for other water quality purposes under the federal acts mentioned above.

(1) Generally Accepted Accounting Principles (GAAP).

**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
SCHEDULE OF REVOLVING AND NON-REVOLVING SRF PROGRAM
REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
SPECIAL REVENUE AND DEBT SERVICE FUNDS
REGULATORY BASIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

	WATER POLLUTION CONTROL SPECIAL REVENUE		WATER POLLUTION CONTROL DEBT SERVICE FUND		DRINKING WATER SPECIAL REVENUE		DRINKING WATER DEBT SERVICE FUND		(MEMORANDUM ONLY)
	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	TOTAL
REVENUES:									
Federal Capitalization Grant Revenue	\$3,865,414				\$9,625,203				\$13,490,617
Interest Income from Investments	623,130	153,955	66,936	(17,433)	119,120	48,237	181,090	45,252	1,220,287
Investment Appreciation/Gains (Depreciation/Losses)	44,409	12,784	(8,432)	3,420	41,059	4,274		(17,150)	80,364
Interest Income from Loans	(15,033)	957,296	2,858,097	1,257,169	964	552,095	1,606,883	624,928	7,842,399
Other Income	43	3	2,586		236	33			2,901
Total Revenues	\$4,517,963	\$1,124,038	\$2,919,187	\$1,243,156	\$9,786,582	\$604,639	\$1,787,973	\$653,030	\$22,636,568
EXPENDITURES:									
Program Administration / Set-Asides	\$135,002	\$401,946			\$1,275,960	\$140,107			\$1,953,015
Total Expenditures	\$135,002	\$401,946	\$0	\$0	\$1,275,960	\$140,107	\$0	\$0	\$1,953,015
Excess Revenues Over/(Under) Expenditures	\$4,382,961	\$722,092	\$2,919,187	\$1,243,156	\$8,510,622	\$464,532	\$1,787,973	\$653,030	\$20,683,553
OTHER FINANCING SOURCES:									
<i>Operating Transfers In:</i>									
Debt Service Sweep	2,127				298,482				300,609
Loan Loss Reserve Sweep	1,530,814				564,762				2,095,576
Investment Earnings from State Special Revenue			643,153				36,215		679,368
Total Other Financing Sources	\$1,532,941	\$0	\$643,153	\$0	\$863,244	\$0	\$36,215	\$0	\$3,075,553
OTHER FINANCING USES:									
Bond Principal			\$2,545,000				\$630,000		\$3,175,000
Bond Interest			631,496				539,215		1,170,711
<i>Operating Transfers Out:</i>									
Debt Service Sweep			2,127				298,482		\$300,609
Loan Loss Reserve Sweep				1,530,814				564,762	\$2,095,576
Investment Earnings to Debt Service	643,153				36,215				\$679,368
Total Other Financing Uses	\$643,153	\$0	\$3,178,623	\$1,530,814	\$36,215	\$0	\$1,467,697	\$564,762	\$7,421,264
Excess (deficiency) of Revenues and Other Financing Sources over (under) Expenditures and Other Financing Uses	\$5,272,749	\$722,092	\$383,717	(\$287,658)	\$9,337,651	\$464,532	\$356,491	\$88,268	\$16,337,842
Fund Balances July 1, 2006	\$148,294,500	\$2,972,229	\$2,386,998	\$2,327,194	\$74,450,799	\$1,405,228	\$1,181,634	\$1,469,685	\$234,488,267
Prior Year Adjustments	63,484	(8,473)			(71,534)	(5,216)			(21,739)
Fund Balances June 30, 2007	\$153,630,733	\$3,685,848	\$2,770,715	\$2,039,536	\$83,716,916	\$1,864,544	\$1,538,125	\$1,557,953	\$250,804,370

This schedule is prepared on a regulatory basis of presentation, rather than a GAAP (1) basis, as requested by the Environmental Protection Agency (EPA) for the Water Pollution Control and Drinking Water State Revolving Fund (SRF) Programs. This presentation separates certain regulated Revolving Fund (within the Fund) and Non-Revolving Fund (outside the Fund) activity by fund type. All proceeds from the EPA Capitalization Grant, corresponding state matching funds, and loan principal and interest repayments must be deposited into the Revolving Fund under Title VI of the Clean Water Act and Title XIV of the Safe Drinking Water Act. Other proceeds, including Administration and Origination Fees and Loan Loss Reserves are deposited into the Non-Revolving Fund and may be used for other water quality purposes under the federal acts mentioned above.

(1) Generally Accepted Accounting Principles (GAAP).

LEGISLATIVE AUDIT DIVISION

C-1

Scott A. Seacat, Legislative Auditor
Tori Hunthausen,
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:
James Gillett
Angie Grove

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND OTHER MATTERS
AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING
BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the financial statements of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs as of and for the fiscal year ended June 30, 2007, and have issued our report thereon dated February 21, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the programs' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the programs' internal control over financial reporting.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described below to be significant deficiencies in internal control over financial reporting.

1. The Montana Water Pollution Control State Revolving Fund Program did not accurately record fund balance related to loans receivable on the accounting records in accordance with generally accepted accounting principles, as required by state law and accounting policy, due to ineffective controls to prevent or detect material errors on the accounting records in a timely manner.
2. The Montana Water Pollution Control and Drinking Water State Revolving Fund Programs did not accurately compile and classify its financial status and results of operations, including related disclosures, in accordance with generally accepted accounting principles and state accounting policy, due to ineffective controls to prevent or detect material errors in the financial statements in a timely manner.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 1 and 2 above to be material weaknesses.

This report is intended solely for the information and use of the Legislative Audit Committee, the departments' management, the Montana State Legislature, and the federal Environmental Protection Agency and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

February 21, 2008

DEPARTMENT OF NATURAL RESOURCES
AND CONSERVATION

D-1



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March 28, 2008

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LEGISLATIVE AUDIT DIV.

Dear Mr. Gillett:

We have received and reviewed the financial audit of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs for the fiscal year ended June 30, 2007.

Please find below the agency's responses to the deficiencies considered to be significant in the Internal Controls over financial reporting.

- 1) **The Montana Water Pollution Control State Revolving Fund Program did not accurately record fund balance related to loans receivable on the accounting records in accordance with generally accepted accounting principles, as required by state law and accounting policy, due to ineffective controls to prevent or detect material errors on the accounting records in a timely manner.**

DNRC concurs. DNRC will include in its Fiscal Year-End (FYE) procedures first, that the Fiscal Officer review all trial balances with Loan Receivables and Advances and allocate Fund Balance to Reserved for L-T Notes/Loans and second, that the Fiscal Bureau Chief do a final review also prior to FYE to ensure proper reservation of all Fund Balances.

DEQ conditionally concurs. DEQ acknowledges the deficiency. DEQ has no means to directly effect corrective action but will assist DNRC's corrective action by ensuring inclusion of a step in DEQ's Fiscal Year-End (FYE) procedures addressing communication and coordination of fund balance adjustments by DEQ and DNRC.

- 2) **The Montana Water Pollution Control and Drinking Water State Revolving Fund Programs did not accurately compile and classify its financial status and results of operations, including related disclosures, in accordance generally accepted accounting principles and state accounting policy, due to ineffective controls to prevent or detect material errors in the financial statements in a timely manner.**

DNRC concurs. DNRC accounting staff will develop procedures for preparation & review of the financial statements to ensure the financial statements provide an accurate presentation of the financial position and results of operation of this program. A final review process will be conducted by the DNRC senior management staff.

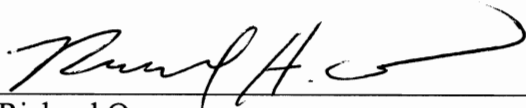
DEQ conditionally concurs. DEQ acknowledges the deficiency. DEQ has no means to directly effect corrective action but will assist DNRC's corrective action by ensuring inclusion of a step in DEQ's procedures addressing performance of a review of the DNRC prepared financial statements for reasonableness and proper formatting by DEQ senior financial staff.

We are pleased with the unqualified opinion and wish to thank your staff for the professionalism and courtesy with which the audit was conducted.

Sincerely,



Mary Sexton
Director, DNRC



Richard Oppen
Director, DEQ